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CONSULTATIONS ON HARMONIZATION AND IMPROVEMENT OF THE RULES OF ORIGIN

Review of past discussions, recent developments and possible ways forward

Report by the UNCTAD secretariat

CONTENTS

		Paragraphs
	Introduction	1 - 3
I.	Conclusions and possible areas for improvements	4 - 11
	A. Key areas where substantial earlier consensus has been reached	5 - 9
	B. Establishment of a work programme	10 - 11
II.	Present origin rules and major problems encountered . .	12 - 41
	A. Purpose and main features of GSP origin rules . . .	12 - 18
	B. Major problems encountered with regard to GSP rules of origin	19 - 20

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CONTENTS (continued)

		Paragraphs
	C. Practical problems with the utilization of the GSP rules of origin identified through technical assistance activities in the field	21 - 41
	1. Problems regarding the origin criterion	22 - 34
	2. Other problems with GSP rules of origin	35 - 41
III.	Implications of the changing economic and policy environment for GSP origin rules	42 - 49
	A. The conclusion of the Uruguay Round	42 - 45
	B. New features of the origin systems of integration groupings involving major developed countries	46 - 47
	C. Liberalization of trade and industrial policies of developing countries	48 - 49
IV.	Possible avenues for improvement of the GSP rules of origin	50 - 77
	A. Harmonization	52 - 58
	B. Liberalization	59 - 61
	C. Cumulation	62 - 66
	D. Concept of donor country content	67 - 68
	E. Special arrangements in favour of least developed countries	69 - 73
	F. Further simplification and improvements	74 - 77

Annexes

Annex

I. Examples of over-strict origin rules

II. Common Declaration with regard to Preferential Rules of Origin

III. North American Free Trade Agreement

IV. EC system of derogation in favour of the least developed countries

INTRODUCTION

1. The Special Committee on Preferences, at its twentieth session, "decided to begin preparations for the 1995 policy review on the GSP. The twenty-first session "... should therefore be considered, inter alia, as a preparatory meeting for the 1995 policy review on the GSP. ... the UNCTAD secretariat [was] requested to prepare in-depth analytical studies on the possibilities for improving the functioning and enhancing the impact of the GSP in the light of the evolution of the international economic and political environment.". 1/

2. The policy review has available for its guidance the Cartagena Commitment adopted at UNCTAD VIII and, in particular, the relevant portions regarding the GSP. 2/ The Conference recognized, inter alia, the advantages of a substantial expansion of product coverage to include hitherto excluded products of current and potential export interest to developing countries and called upon preference-giving countries to consider, if possible, comprehensive product coverage, especially where a review of their schemes was under way. Limitations and restrictions of preferential imports as well as withdrawals of preferential benefits should be minimized, and the rules of origin should be simplified and harmonized, where possible, so as to impart stability, transparency and greater predictability to the schemes and reduce their complexity. The Conference called further for the implementation of GSP improvements in favour of the least developed countries. With MFN rates brought down by the conclusion of the Uruguay Round, preference-giving countries are further expected to consider. where possible, increasing preferential margins and duty-free treatment offered under existing preferential schemes in order to offset the possible erosion of GSP benefits. Many of these recommendations have also a bearing on the review of GSP rules of origin which ought to contribute to the realization of the above-mentioned objectives of the Cartagena Commitment to the extent possible.

3. This report is intended:

(i) to facilitate a comprehensive review by the Special Committee on Preferences of the GSP rules of origin, their shortcomings and possible improvements, taking into account discussions and conclusions reached within UNCTAD over the past two decades and developments outside the GSP;

(ii) to make recommendations for the implementation of positive improvements in origin rules as part of the preparations for the 1995 policy review.

Chapter I

CONCLUSIONS AND POSSIBLE AREAS FOR IMPROVEMENTS

4. The Cartagena Commitment, the follow-up considerations by the Special Committee, the conclusion of the Uruguay Round and the current review of GSP schemes of major donor countries, have set the stage for a major review of the GSP and its rules of origin. The post-Cartagena conclusions reached by the Special Committee should enable progress to be made towards effective implementation of some important improvements in GSP origin rules. The results of the Uruguay Round should induce preference-giving countries to review at an early date the compatibility of their rules with their new commitments as regards origin, and launch a more comprehensive review process towards harmonization, simplification and effective liberalization of the GSP rules of origin. Such a review should acknowledge the fact that MFN duties and GSP preferential margins have come down to very low levels for broad sectors of industry and to zero levels for a number of them: origin requirements should be adjusted to that move in tariffs, adapted more closely to production possibilities in the majority of smaller- and medium-sized developing countries and take full account of the problems encountered by these countries in complying with origin requirements under the GSP. This review should further take into consideration the liberalization of the trade and industrial policies of many developing countries as well as the globalization strategies of international investors.

A. Key areas where substantial earlier consensus has been reached

5. At its twenty-first session, the Special Committee should therefore, as one of its tasks, focus its attention on the means to reach a final consensus and begin the process of implementation in those key areas where a substantial degree of consensus had already been reached in earlier sessions. 3/

6. With respect to harmonization of origin systems, some pragmatic steps should be considered for making further progress:

(a) in the course of the implementation of the Uruguay Round Agreement on Rules of Origin and the annexed Common Declaration with regard to Preferential Rules of Origin, 4/ the basic concepts and definitions of all origin rules applied by contracting parties have to be re-examined regarding their clarity, transparency and predictability. In this same process preference-giving countries should also take account of difficulties enccuntered with concepts and definitions of their origin rules for GSP. An important step would also be taken towards harmonization of GSP rules of origin of countries applying the percentage criterion if consensus could be reached by the Special Committee to recommend a single definition of the origin criterion: the definition that imported materials should not exceed a certain percentage of the f.o.b. export price (or eventually the cost of the exported product) would appear to come closest to the requirements of clarity, predictability and simplicity of application for exporters;

(b) with a view to fostering full harmonization of origin systems, 5/ the Committee may wish to consider some guidelines for such a change in systems:

(i) a change of basic origin criteria should not introduce new requirements for individual products and sectors which are more restrictive than the equivalent of its previous expression;

(ii) any change to the HS-based system should not introduce specific process criteria on the single list, which are more restrictive than any criterion already used by other GSP donors in their single lists for the same product or sector.

7. A second key area is cumulation. 6/ The Special Committee should explore means of meeting the concerns of certain preference-giving countries, which are hesitant about applying this concept in view of the high competitiveness of certain developing country industries producing intermediate materials and components. To that effect it may wish to consider the proposal that materials, components and other inputs subject to any form of graduation measures would not be taken into account for the purpose of preference-receiving country cumulation. Preference-giving countries that have not yet introduced global cumulation should be invited to indicate whether they would be prepared to implement this concept on the basis of such a consensus, or whether they would prefer to proceed by stages, starting with cumulation within the two groups of preference-receiving economies in transition and developing countries. The Special Committee may also provide a forum for an exchange of experiences with countries applying full cumulation for GSP purposes as regards appropriate administrative measures for applying full cumulation to a large number of beneficiaries.

8. In the context of progressing towards the implementation of full and global cumulation amongst GSP beneficiaries, the scope for introducing donor country content should be further considered.

9. The broad consensus reached by the Special Committee to offer special benefits to all the least developed countries concerning every aspect of the GSP should be translated into action at the earliest possible date. Possible ways of doing so include:

(a) providing the possibility of derogations for specific products at the request of a least developed country, as in the EC scheme;

(b) allowing lower value-added requirements for least developed countries (i.e. 60 per cent of imported materials instead of the general 40 per cent), as in the case of the Canadian scheme; or,

(c) simplification and relaxation of the origin requirements across the board through full application of the HS tariff change on the basis of its headings and sub-headings (6-digit) without any further specific criteria attached (as an alternative to present process lists during an experimental period);

(d) The application of donor country content and full cumulation for all least developed countries.

B. Establishment of a work programme

10. As a second task, the Special Committee may wish to consider establishing a work programme, as part of the 1995 policy review, for a comprehensive review of GSP rules of origin, in the light of difficulties encountered, the detailed results of the Uruguay Round in terms of effective changes in MFN tariffs, and the changes that may result from the major GSP review itself, in particular in terms of removal of product exceptions and extension of product coverage.

11. A major task of this review would consist in exploring the scope for liberalization of GSP origin requirements resulting from the reduction of the MFN duties to low levels in most industries, or the elimination of origin requirements altogether in sectors where MFN rates are reduced to zero:

(a) With respect to process lists, this would require a product-by-product examination of the remaining sectors to which GSP benefits will continue to apply. A substantial reduction of the restrictiveness of origin criteria and a simplification of administrative requirements should re-establish a certain correspondence with the cost of obtaining GSP access also taking into account the eroded preferential benefits resulting from the Uruguay Round and the rapid geographical extension of preferential arrangements implying major GSP donors. This review should ideally result in a single specific requirement per product or sector, without any further requirements;

(b) In the context of the percentage criterion, a corresponding review of possibilities for liberalization should include the adjustment of the percentage requirement to the prevailing production conditions and possibilities of the majority of industrially not far advanced smaller and medium-sized developing countries;

(c) As an initial step towards this liberalization, the Committee may wish to consider the proposal that all cumulative input requirements that go beyond the tariff change, the definition of a maximum amount of material imported, or the definition of specified production processes, should be eliminated as soon as possible. A corresponding move should be made by donor countries applying the percentage criterion or, as the case may be, switch to the process criterion. Donor countries should report on the progress made to the next session.

Chapter II

PRESENT ORIGIN RULES AND MAJOR PROBLEMS ENCOUNTERED

A. Purpose and main features of GSP origin rules

12. Entry into a preference-giving country at GSP rates of duty requires goods to have originated in a preference-receiving country in accordance with the rule of origin prescribed by the importing country. The purpose of these rules are:

(i) to prevent or limit possible "deflection of trade" i.e. the undermining of the customs tariff of a preference-giving country. This would occur if preference were granted to third country goods which had merely transited through or undergone only nominal processing in a preference-receiving country;

(ii) to encourage genuine manufacturing in preference-receiving countries so as to promote exports, thus to increase earnings of foreign currency and to promote industrialization and employment.

13. All preference-giving countries require goods to be either wholly the produce of a preference-receiving country or, where goods are produced from materials imported from outside that country, those materials must have undergone "substantial transformation" in the exporting preference-receiving country.

14. Origin must in principle be acquired in a single preference-receiving country. However, certain preference-giving countries permit the "cumulation" of materials supplied by any other preference-receiving countries or within subregional integration groupings. Further, in some origin systems (Japan, to a limited extent, Australia, Canada, New Zealand), materials supplied by a preference-giving country may be used in a preference-receiving country for manufacture into a product which is then exported to the supplying country: this arrangement is referred to as the "donor country content" concept.

15. The term "substantial transformation" is defined either by means of a "percentage criterion" (Australia, Canada, New Zealand and the United States) or a "process criterion" (EFTA preference-giving countries, EC and Japan). Both criteria place limitations directly or indirectly on the use of imported materials. The process criterion is expressed by means of a basic rule which requires imported material to undergo a change of HS classification (at the four-digit level) in the course of manufacturing in a preference-receiving country. In the case of a number of products excepted from that rule, separate rules specific to those products must be satisfied. Many of these rules place a percentage limit on the use of imported materials.

16. The countries applying the percentage criterion express it differently in terms of both its definition and the percentage restricting imported materials. In the case of the process criterion, the basic rule is common to all the preference-giving countries concerned. In regard to the specific

rules applied to products excepted from the basic rule, there are however differences in substance between the countries concerned (except among the EFTA countries).

17. Further origin requirements state that most preference-giving countries do not accept "minimal processes" as conferring origin even though the appropriate criterion may have been satisfied. Furthermore, the products must be consigned or transported directly to the preference-giving country.

18. Detailed documentation provisions and ancillary procedures aim to ensure that compliance with the origin rules is established, certified and can be verified. Detailed provisions regulate the format, and lay down the size and paper quality of the certificate of origin which establishes the proof of origin, as well as its completion and issuing. Methods of administrative cooperation between preference-giving and beneficiary countries specify procedures for identifying the authorized certifying institutions, as well as for assistance in the verification of the authenticity of the origin document and the attestation of the accuracy of the information regarding the true origin of the products in question.

B. Major problems encountered with regard to GSP rules of origin

19. Throughout the two decades of existence of the GSP, the shortcomings of the origin system and consequent obstacles to GSP utilization have been identified by preference-receiving countries as well as in the course of technical cooperation activities, and discussed in the context of the Working Group on Rules of Origin and in the Special Committee on Preferences. 7/ The government institutions have repeatedly recognized and agreed on the need for improvements and some progress has effectively been made regarding specific provisions of individual schemes. However, major problems with respect to GSP origin still persist regarding harmonization, liberalization and simplification of the scheme, and hamper the achievement of the original objectives established in the GSP, especially in a large number of smaller and medium-sized developing countries.

20. The main shortcomings of the various GSP origin systems encountered by preference-receiving countries can be grouped under the following main headings:

(i) over-restrictiveness of the basic origin criteria to permit the use of imported materials and components (see annex I);

(ii) the frequent additional requirements further restricting the use of third country inputs attached to process and percentage criteria, such as requirements for "double or triple tariff jumps" instead of a simple change in tariff positions, the specification of components or additional inputs, which have to originate in the beneficiary country, and the like;

(iii) the diversity of rules applied by preference-giving countries with respect to the basic criteria (e.g. process and percentage criteria); the differing versions of the percentage criteria or requirements in virtually all GSP origin systems; as well as the substantial differences between individual schemes regarding additional origin requirements. They create difficulties for exporters, as products may qualify in one preference-giving country, but not in a neighbouring market, and this may cause additional administrative adjustments;

(iv) the limited recognition of rapidly expanding economic cooperation and trade among developing countries generally and subregional integration in particular, which would require generalization of cumulation. Equally, the rare application of donor country content limits subcontracting and processing traffic;

(v) the detailed and complex ancillary origin criteria, direct consignment requirements, administration, documentation and verification, which may imply substantial additional cost for GSP transactions;

(vi) the persistent difficulties of least developed countries in coping with several of these aspects of the origin systems of the GSP donor countries.

C. Practical problems with the utilization of the GSP rules of origin identified through technical assistance activities in the field

21. This section draws on the experience accumulated by the UNCTAD Technical Cooperation Programme on the GSP and Other Trade Laws while conducting its activities in beneficiary countries. It provides an overview of the findings by exporters or manufacturers in utilizing the actual GSP rules of origin. It outlines lessons learned and points to certain technical and practical improvements that are required in the rules of origin.

1. Problems regarding the origin criterion

22. In the scheme of the United States, some major problems have arisen due to the vagueness and lack of clear definitions regarding basic elements of the scheme. This applies in particular to the value base for calculating the percentage requirement, i.e. the "appraised value"; to the precise definition of "direct cost"; and to the origin determination of sub-assemblies or intermediate products that are incorporated into the final product.

23. These origin rules for GSP provide that at least 35 per cent of the appraised value of the final product or manufacture of a preference-receiving country must consist of:

(a) the direct cost of processing operations performed in the beneficiary country;

(b) the cost of the value of material produced in the beneficiary country and "the cost or value of any article incorporated in the eligible article which has resulted from substantial transformation of any imported materials into a new and different article of commerce".

24. The provisions regarding determination of the origin of intermediate products or sub-assemblies contained in (b) above do not specify clearly what is considered a "substantial transformation" nor does the concept of a "new and different article of commerce" provide such clarification. In practice the term "substantial transformation" is left to be decided by the United States Customs Service on a judge-made basis. 8/ This case-law system has been challenged in the United States courts but the outcome of the cases has yet to remedy the vagueness of this determination. From the beneficiary exporter's point of view it is difficult to deal with such a vague definition. Furthermore, practical advice on determining the origin of such sub-assemblies could only be given by a practising lawyer or by the United States Customs Service, and requires an excessive in-depth knowledge of rules of origin requirements by exporters and certifying authorities. Second, the United States rules of origin do not specify whether value-added contained in an intermediate product, which does not meet the requirement of substantial transformation, can be counted towards the direct cost of processing operations, or whether the total value of such sub-assemblies is to be considered as an imported input.

25. Furthermore, the United States GSP rules of origin would gain substantially in clarity and predictability if the "appraised" value were clearly defined. It appears that in practice the "appraised value" is normally the equivalent of the ex-factory price of the goods. However, there is no apparent reason why the value base and the direct cost cannot be clearly defined in the GSP rules of origin themselves.

26. In general terms, manufacturers and exporters find that the different modalities on which the percentage criterion of preference-giving countries is based are difficult and confusing. In the case of the United States which, like Australia, New Zealand and Canada utilizes a value-added percentage, only the costs of direct processing and of local materials can be counted as a numerator for the minimum percentage requirement. Other preference-giving countries that apply the percentage method specify a higher minimum amount of local value-added but allow profit and overheads to be included in the numerators. Other countries like the EC member States, EFTA preference-giving countries and Japan utilize as a subsidiary criterion in their single list a percentage criterion of maximum imported inputs allowance. The value of these inputs in the case of the EC and EFTA may not exceed a given percentage (40 per cent, 5 per cent, etc.) of the ex-works price of the final product. In the case of Japan the denominator is the f.o.b. price. There is a tendency, if not a consensus, among exporters/manufacturers to prefer the adoption of a maximum imported inputs allowance rather than a minimum value-added requirement. There are two reasons for this preference:

(a) the percentage calculation of the value of the imported input is easier to compute and the value of the imported input may be supported by suppliers' invoices. For example, the EC and EFTA schemes provide clear rules on this aspect:

> "The term 'value' ... shall mean the customs value at the time of importation of the non-originating materials used or, if this is not known and cannot be ascertained, the first ascertainable price paid for the materials in the country concerned";

(b) the calculation of the value-added is complex as it entails (i) a distinction of costs, which could be computed as local value-added, and (ii) itemization of such cost to the single unit of production. As a consequence it often requires accounting, and discretion may be used in assessing unit costs. Additionally, currency fluctuations in beneficiary countries may affect the value of the calculation.

27. In the case of the GSP schemes of Australia, Canada and New Zealand, the rules should contain an explicit discipline for the intermediate product, which at present is totally absent. Such a situation creates uncertainty and lack of transparency when these GSP schemes are utilized.

28. The GSP schemes of the EC and EFTA preference-giving countries and Japan have independently adopted the process criterion since the inception of their schemes, i.e. change of tariff heading coupled with the so-called "single list" of exceptions to the basic rule. With some minimal variations the same rules and the same lists apply for the EC and EFTA schemes, while, in the case of Japan, there are differences produced both by developments over the years or by voluntary amendments. Attention here focuses on the single list which lays down for specific products the detailed working or processing that has to be carried out on non-originating material in order to confer originating status to it. However, the exception (i.e. inclusion in the list) has become the rule. The "single list" rules frequently not only require specific working or processing but add supplementary processing requirements, such as:

- purely technical requirements; 9/
- general value-added tests; 10/
- maximum imported inputs allowance tests combined with additional restrictions; 11/
- maximum imported inputs allowance tests with obligatory inputs; 12/
- maximum imported inputs allowance tests with specific input restrictions on certain non-originating ingredients 13/ or requirements of specific originating inputs; 14/
- change of tariff heading tests with the possibility of using a limited amount of materials from the same heading. 15/

29. An example of this requirement in the EC and EFTA single lists is tariff heading 8525 "Transmission apparatus for radio-telephony, radio-telegraphy, radio-broadcasting or television, whether or not incorporating reception apparatus or sound recording or reproducing apparatus; television cameras", which requires

- manufacture in which the value of all the non-originating materials used does not exceed 40 per cent of the ex-works price of the product (=percentage test); and

- where, within the above (40 per cent) limit, the materials classified within heading No. 8529 16/ are only used up to a value of 5 per cent of the ex-works price of the product (=input restriction); and

- where the value of all the non-originating materials used does not exceed the value of the originating materials used (=value-of-parts test); and

- all the transistors of heading 8541 used are originating products (=obligatory input).

30. Manufacturers and exporters have complained about the stringency of this rule especially where it refers to the obligacory input (transistors). The tariff jump is generally replaced by a 40 per cent maximum imported inputs allowance requirement for all machinery, electrical machinery and appliances, most vehicles and scientific and other instruments (chapters 84, 85, 86, 87 and 90). In these chapters, additional restrictions on the use of imported materials are frequent for a number of important products. The transistor rule also applies to microphones, loudspeakers, record players, tape recorders, video recorders, etc. Additional restrictions are often imposed on the use of other inputs under different tariff headings. Other specific restrictions of that type can for example be found for sewing machines (8452): in addition to a 40 per cent maximum imported inputs allowance, imported materials may not exceed the value of originating materials used for assembling the head; and the thread tension, crochet and zigzag mechanisms used must be originating products. The use of materials falling within the same four-digit tariff heading is only allowed up to 5 per cent of the ex-works price of the product, which is another rule that frequently causes problems for exporters.

31. Japan uses for machinery and electrical appliances basically the same general rules requiring a 40 per cent maximum imported inputs allowance and limiting the use of parts and components from the same four-digit tariff heading to 5 per cent. But Japanese rules for such products usually do not stipulate additional requirements and are therefore often less stringent than those under the EC and EFTA schemes. There are, however, some exceptions, for example, with respect to the use of imported razor blades for the production of motorized shavers and hair clippers (tariff heading 8510): the only manufactures to qualify are those in which the value of the non-originating products of a different tariff heading from the products obtained and non-originating razor blades of heading No. 8510 does not exceed 40 per cent of the value of the products obtained, and also in which

the value of the non-originating products (excluding razor blades) of the same tariff heading as the product does not exceed 5 per cent of the value of the products obtained.

32. It may be argued that the different use of additional specific requirements in the single lists can to some extent be explained by different choices made by donor countries regarding the measures used by such countries to administer safeguards or distribute preferential access benefits. The Japanese GSP scheme relies more on the administration of ceilings (through monthly, daily or prior allotments) and maximum country amounts, coupled with explicit product exclusions for administering and distributing the benefits of the scheme. The EC has opted for a mixture of a priori limitations and restrictive rules of origin to administer safeguards or differentiate GSP benefits between beneficiary countries and between more or less sensitive products.

33. Some positive steps have also been taken towards relaxing certain criteria. The introduction of the Harmonized System has to some extent increased the number of four-digit tariff headings (by about one fifth). This may have led to some relaxation of origin requirements based on the change in tariff headings, for example in Japan. On the other hand, EC and EFTA countries have, on the occasion of the changeover to the Harmonized System, added further products to their single lists and subjected them to specific requirements. They have thus compensated partly for the potential effects of this change.

34. Furthermore, Japan has recently removed the "double-jump" requirement for most clothing and accessories in Chapter 62:

(i) according to the past rules of origin under Japan's GSP scheme, as in the case of the EC and EFTA preference-giving countries, "Articles of apparel and clothing accessories, not knitted or crocheted", included in HS Chapter 62, have been considered as originating only when they were manufactured from textile yarn. This is the famous "double-jump" requirement, where two stages of manufacturing have to be carried out, i.e. from textile yarn to fabric and from fabric to apparel;

(ii) the amendment of the rules of origin relaxed the rule in such a way that the articles falling in HS Chapter 62 are eligible for GSP even if they are manufactured directly from imported fabrics. 17/

2. Other problems with GSP rules of origin

35. Further important problems have been encountered by preference-receiving countries regarding a number of ancillary rules and administrative procedures established by certain donor countries' schemes.

(a) Clarity of rules

36. An important improvement of GSP schemes would be if all preference-giving countries were to provide explanatory notes to their schemes, as is done, for example, by the EC. These notes have been very useful for interpreting and understanding the rules and provisions of the single list. Explanatory notes could generally impart transparency and predictability, and facilitate the application of the rules of origin.

(b) Cumulation

37. Certain preference-giving countries have introduced facilities for cumulation in favour of certain subregional groupings. The EC has established specific modalities for implementing such cumulation. None the less, basic misunderstandings of the conditions under which such cumulation might be applied in favour of exports from integration groupings have hampered for a considerable time the full utilization of this facility. In order to avoid such misunderstandings in future, the precise requirements should be clarified by individual preference-giving countries in their GSP rules regarding the scope, procedures and implementation of their cumulation facilities.

38. With respect to the type of cumulation allowed (e.g. full or partial), it may also occur that partial cumulation is not sufficient, as it does not allow full account to be taken of value-added components acquired in eligible countries. Furthermore, in certain cases of specific criteria the partial regional cumulation can be more restrictive than full regional cumulation. For example in the case of the EC, a clothing article qualifies if the manufacturing process starts from yarn. Under full regional cumulation, member country A may import yarn from a third country and spin it into a fabric; member country B imports that fabric from A, manufactures it into garments and can export the finished product to the preference-giving country under GSP. The same process cannot be applied under partial cumulation, because the fabrics would not be considered as originating in country A: fabrics only originate in a country if produced on the basis of fibres. Thus an additional manufacturing process is necessary in the case of partial cumulation.

39. Another aspect of regional cumulation that may hamper its utilization are doubts about allocation of the origin between the member countries of the group. While EC regulations clearly provide the criteria for the allocation of origin, the provisions of the other preference-giving countries are vague in this respect. The importance of the allocation of origin relates, in particular, to the quotas allocated under the Multifibre Arrangement or under the GSP schemes to which imports from the member countries of regional groupings may be submitted. Between the same countries there could be a differentiation of benefits for the same products. Therefore intraregional trade and utilization of regional cumulation might be discouraged in the absence of clear rules. Countries may wish to utilize the national quotas for their entirely home-made products rather than utilize semi-finished products imported from other member countries. Issuing authorities may refuse to issue the final GSP Form A unless they are sure that the shipment is going to be counted against the real country of origin.

(c) Direct consignment

40. All preference-giving countries, except Australia and New Zealand, provide for rules regarding the conditions for transport of goods to beneficiary countries. Their purpose is to enable their customs administration to ascertain that the imported product is the same as the one originally shipped, and that it has not been manipulated, substituted, further processed or entered into commerce in any third country. However, Canada requires the direct consignment of the goods from the originating country to a final consignee in a specified port in Canada, with proof in the form of a through bill of lading. This rule is very stringent, as exporters must know the name of the consignee in the specified port in Canada at the time of the shipment and thus it limits the use of GSP by intermediaries in a third country even if the products in question meet other origin rules. This is true particularly in the case of least developed and land-locked countries as most of them lack direct transport facilities and this consequently prevents the issuing of a through bill of lading. Similarly, in the case of the United States, goods must be destined for that country at the time of departure from the country of origin, though transshipment may be allowed under certain conditions.

(d) Documentary evidence

41. Certain developing countries face substantial difficulties in coping with the very stringent precisions regarding the format, size and paper quality of the internationally agreed Form A for the Certificate of Origin. 18/ In some of them, the special paper quality is not available. In least developed countries in particular one of the big problems hampering GSP utilization is the non-availability of Form A. While it is highly desirable to maintain GSP Form A as an internationally recognized form, it is recommended that the requirement as regards the quality of the paper should be relaxed, at least for LDCs.

Chapter III

IMPLICATIONS OF THE CHANGING ECONOMIC AND POLICY ENVIRONMENT FOR GSP ORIGIN RULES

A. The conclusion of the Uruguay Round

42. The conclusion of the Round will have a significant impact on GSP and on the possible reform of origin rules, especially as regards the reduction of GSP preference margins. In this connection, some preference-receiving countries at the twentieth session of the Special Committee on Preferences "expressed concern and called for favourable adjustment of preferential margins". They also requested the secretariat to "study the impact of the Uruguay Round and identify the follow-up action required to strengthen the effectiveness of GSP". 19/ This erosion of preferences through the Uruguay Round has been compounded by the creation of new integration and preferential arrangements around major trading nations and the rapid geographical expansion of those already existing and increased the need and rationale for GSP improvement.

43. The conclusion of the Uruguay Round sets a new environment for GSP and its origin rules in all major categories of further action: liberalization, harmonization and simplification. First, the Uruguay Round will substantially reduce tariffs on industrial products. In fact, an average of approximately 40 per cent reduction of MFN tariffs on industrial products in major donor countries will bring down the majority of MFN rates in that area to less than 5-6 per cent. At such low levels of preferential GSP margins, the risk of deflection of trade within the GSP context will drastically diminish for the bulk of industrial products. Together with the reduction of this risk, for which origin rules are finally designed, this tariff reduction should open up opportunities for a substantial liberalization of origin criteria over a wide range of industrial sectors. The GSP origin rules and criteria had been devised at a time when customs duties had been high and many non-tariff restrictions had been in force, which motivated the tight origin requirements which the rules imposed on beneficiary suppliers. With the profound change in this situation for most industries, such tight rules and criteria have lost much of their justification. Even the remaining industrial sectors with high protection levels at present are to be brought progressively under the provisions of GATT.

44. Second, the Uruguay Round Agreement on Rules of Origin confirms the trend already recognized by the Special Committee on Preferences towards international harmonization of various national rules of origin. The Agreement shares a number of its objectives with the underlying aspirations of the proposals for improvements in the GSP origin rules, for example, the need to ensure that "rules of origin themselves do not create unnecessary obstacles to trade"; that "rules of origin are prepared and applied in an impartial, transparent, predictable, consistent and neutral manner"; and that "rules of origin ... shall not pose unduly strict requirements". 20/ Disciplines to govern the application of non-preferential rules of origin during a transitional period have been complemented by a work programme for their harmonization. Their harmonization will be based essentially on the criterion of a change of tariff headings or sub-headings of the Harmonized

System. While not directly applicable to the GSP and other preferential rules of origin, these provisions are nevertheless likely to constitute an important consideration for the formulation of future national origin rules by WTO member States. The Common Declaration with regard to Preferential Rules of Origin annexed to that Agreement takes over many of the rules established by the Agreement itself regarding clarity of definition of origin criteria, transparency and predictability of the application of those rules, the possibility of appeals and international notification of changes, and makes them thus equally applicable to preferential rules of origin. This includes, as a new feature, the possibility for traders to request an advance assessment of preferential origin before trade has actually begun (see annex II).

45. Thirdly, the Uruguay Round results should also motivate a thorough examination of the scope for simplification of the various documentary and administrative requirements for the GSP. The requirements for certain provisions and detailed administrative procedures may have lost some of their relevance when most tariffs will have been reduced from 20-30 per cent in the 1970s to around 5 per cent in the 1990s. At such low rates, an examination seems indispensable, in order to adjust the cost of GSP transactions arising from documentation, origin certification and customs procedures to the drastically reduced GSP preference margins. Otherwise a disproportionate share of the post-Uruguay Round benefits from GSP will be absorbed by the cost involved in claiming and obtaining the benefits.

B. New features of the origin systems of integration groupings involving major developed countries

46. The North American Free Trade Agreement (NAFTA) is another example of the international trend towards harmonization of origin systems along the principle of the change in tariff headings even for the purpose of preferential arrangements. This Agreement, which came into force on 1 January 1994, provides for the progressive elimination of customs tariffs and non-tariff restrictions on goods originating in and traded between the United States, Canada and Mexico. The new Agreement brings about a major change in origin definition as compared to the GSP rules of origin of the United States and Canada, which use the percentage criterion for the purpose of establishing origin. The new origin rules of NAFTA stipulate that originating materials must, in principle, undergo a change in tariff classification, based on the Harmonized Commodity Description and Coding System (HS) to establish their substantial transformation. There are, however, several products for which NAFTA establishes additional origin requirements, including a triple HS jump for certain clothing products and relatively high percentages of regional value-added requirements. These additional criteria and requirements mainly reflect the wide-ranging availability of intermediate products and components in the United States and the NAFTA region more generally, and the advanced stage of industry in the two industrialized member States. The general definition of originating products (art. 401) as well as some examples of rules of the type applying to some textile machinery, electrical products and automotive components are reproduced in annex III. This shift by the United States and Canada towards the use of the process criterion for determining preferential origin within NAFTA is an important development at a time when both countries are also reviewing their current GSP schemes. 21/

47. The new European Economic Area Agreement, which likewise came into effect at the beginning of 1994, contains interesting new and more flexible origin arrangements and a substantial simplification of its administration for beneficiary enterprises. Thus, EEA extends full regional cumulation to its five EFTA members. Furthermore, enterprises that are continuous suppliers to the EEA need no longer undergo origin certification procedures for each individual shipment, but may obtain a long-term authorization for multiple deliveries.

C. Liberalization of trade and industrial policies of developing countries

48. The widespread trend towards import liberalization and industrial deregulation in developing countries since the mid-1980s has wide-ranging implications for their industries and the mode of their integration into international production patterns and specialization. Through this change of policies, many developing countries have forgone major tools used in the past to protect and promote particular industries and vertical integration. On the other hand, they expect to participate to a greater extent in international specialization with those production processes and products in which they have comparative advantage and to gain in attractiveness for foreign direct investment. GSP rules of origin should be adapted to the change in industrial production patterns: origin criteria that impose extremely high value-added and component requirements for certain products need to be relaxed to enable developing countries to participate in the new globalized patterns of decentralized industrial investment and production.

49. In the same vein as the reforms of government policies, emerging patterns of business-led integration and the extension of TNC networks to certain developing countries, regional integration among them, have gained new impetus. Mutual trade, investment and production linkages have expanded in an unprecedented manner among, in particular, Asian developing countries and within certain Latin American groupings. GSP origin rules should follow and support these trends by extending subregional cumulation to further integration groupings among developing countries where this is not yet the case, as well as introduce facilities for regional (for example African) and global cumulation among GSP beneficiaries.

Chapter IV

POSSIBLE AVENUES FOR IMPROVEMENT OF THE GSP RULES OF ORIGIN

50. Preference-giving and preference-receiving countries agreed a long time ago on the need for substantial improvement of GSP rules of origin through their harmonization, simplification and, where possible, liberalization. Nevertheless, hardly any major progress has been made in that direction or towards effective implementation of the Cartagena Commitment.

51. The Cartagena Commitment, the conclusion of the Uruguay Round and the ongoing reviews of major GSP schemes should set the stage for the effective progress and implementation of previously reached agreements on improvements in the GSP origin systems. Already in May 1992, the Chairman of the Special Committee on Preferences had expressed the expectation that a fruitful outcome of the Uruguay Round negotiations would lead to a substantial reduction in duties, which would in turn render rules of origin less meaningful and allow room for a more liberal approach to harmonization.

A. Harmonization

52. One area where the gap between the stage of consensus reached and actual implementation has been greatest relates to harmonization of GSP origin rules. At its 1992 session, the Committee had reaffirmed that the case in favour of harmonization of GSP origin rules had already been established. The review of national GSP schemes undertaken by preference-giving countries should therefore include the possible harmonization of rules of origin. However, the Committee left open the various options in regard to the basis and scope of any harmonization: it stated, however, that some movement in favour of the process criterion was evident, and that a similar trend existed in regard to non-GSP rules of origin. 22/

53. Harmonization would facilitate regional diversification of exports from developing countries and avoid the necessity of adjusting production processes and components sourcing to different origin requirements in different preferential markets. Harmonization would therefore enhance the effectiveness of GSP and substantially simplify its application for exporters. Maximum benefits would derive in that respect from full harmonization, in the sense of the convergence of all preference-giving countries towards the same origin criteria for each product or sector. The adoption of the Harmonized System was an important step that would technically facilitate such a convergence, but is not sufficient, in itself, to produce harmonized and uniform criteria for individual products. Full harmonization also requires harmonization of the specific criteria on the single list as they affect a large portion of developing countries' exports. If a country switches to the process criterion, the specific requirements should neither be more restrictive than their previous percentage equivalent, nor more restrictive than any specific criterion stipulated for the same product or sector in process lists of other preference-giving countries. The undertaking of a similar product-by-product examination of single lists should be envisaged, as planned by the WTO for non-preferential origin rules, regarding the applicability of the change in tariff headings and sub-headings of the Harmonized System nomenclature or regarding alternative specific requirements.

54. The implementation of the Common Declaration could also provide an opportunity for moving in the direction of two-track harmonization of GSP rules of origin among the countries using the percentage criterion. No progress has in fact been made over the past 20 years regarding the originally envisaged harmonization of that criterion, which is now applied as a basic criterion by the United States, Canada, Australia, New Zealand, Poland, Hungary, the Czech Republic, the Slovak Republic, Bulgaria and the Russian Federation. As indicated above, the percentage criterion is also used frequently to define specific origin requirements for a large number of products or sectors by the "process criterion countries". These rules vary widely in the specific expression and definition of origin as well as the percentage itself. In addition, the ways in which percentage criteria are defined vary with respect to precision, clarity and simplicity of application.

55. Some donor countries, such as Canada, provide a clear and simple definition of the percentage criterion in terms of imported materials permitted as a percentage of the ex-factory price of the finished product. This definition specifies clearly the limits up to which imported materials can be used. A second form of the percentage rule defines value-added, in a positive manner, as a percentage of export prices or production cost, and is used by Australia and New Zealand: the application of this definition is more complex, requires accounting and introduces a certain degree of discretion regarding the precise components of value-added and their calculation for individual products. A third expression of the percentage criterion used by the United States stipulates that direct cost of production may not exceed 35 per cent of the appraised value of the exported product. This expression has, as shown above, led to practical difficulties due to the vagueness of the definition of what is the "direct cost" of producing an export product, what is its "appraised value", and what constitutes the accountable value of sub-assemblies or materials used in the production process. While the 35 per cent value-added criterion appears to be relatively liberal, this effect is likely to be offset by the more restrictive direct cost base for its calculations. This definition implies a very narrow concept of the cost of an export product: enterprises without management, production without cost accounting, and exports without marketing. Furthermore, this criterion does not allow an exporter to know precisely what quantity of materials could be imported as this depends largely on the proportion of indirect cost. Therefore, it appears that not all the three main types of definition of the percentage criterion correspond equally to the provisions of the Common Declaration, i.e. (i) that the requirements to be fulfilled are clearly defined and (ii) that the method for calculating the percentage required is also to be indicated in the preferential rules of origin.

56. Some adjustment of the definitions and the expression of the percentage criterion may therefore become necessary in certain GSP schemes as a result of the Common Declaration. This occasion could be used to harmonize the percentage criterion, where used for GSP purposes, according to its clearest and simplest expression: namely, that the value of non-originating materials used shall not exceed a certain percentage of the f.o.b. export price of the finished product (or eventually, as a variant, it could be based on ex-factory price, although these costs, do not appear on the commercial invoice).

57. In all types of origin systems, the requirements for intermediate inputs could be defined as being the same as for the finished product, unless specified otherwise in a process list. National value-added components integrated into an intermediate product should be taken into account for calculating the origin of the finished product.

58. Harmonization of origin systems based on the process criterion is likely to make further progress if and when most EFTA countries become full members of the European Union and take over the GSP of the EC and its origin rules. In the near future, therefore, only the EC, Swiss and Japanese origin rules will remain in application. Although they are already harmonized to a large extent among themselves, there is substantial scope for proceeding along the path of liberalization of the specific process criteria contained in the respective single lists.

B. Liberalization

59. As shown by their operational experiences in the field, many enterprises have encountered problems with the excessive restrictiveness of certain specific origin requirements stipulated by countries using basically the process criterion. Earlier documentation (TD/B/C.5/141) has already made the case that criteria for "substantial transformation" should not imply "total transformation". This problem arises frequently when process lists specify additional or cumulative origin requirements, in particular specific input requirements over and above the tariff jump and/or a limitation of the value of materials used: for example, the requirements that razor blades for electric shavers need to be originating products, or transistors for consumer electronics, or zig-zag and other mechanisms for sewing machines, or sugar for orange juice, or the requirements limiting the use of materials of other tariff headings to minimal percentages of the value of the export product. Many smaller and medium-sized developing countries have pointed out that such requirements are not within the reach of their national production capacities. Many of these criteria, which date from the Yaoundé Conventions, do not even correspond any longer to the production organization of major TNC producers, which may have long since relocated the production of such components and materials to other specialized companies abroad, inter alia, in developing countries. At the low tariff rates resulting from the Uruguay Round for most of the product concerned, the time has now come to examine the possibility of removing such additional criteria and input requirements and simply maintaining a single criterion for each product or sector.

60. More generally, a review should be undertaken of all existing origin schemes and process lists to determine to what extent the reduction of tariffs as a result of the Uruguay Round makes it possible to substantially relax the origin requirements for GSP, whether specific or in percentages. As many products are likely to disappear from GSP coverage and origin criteria simply as a result of the "zero-option" for post-Uruguay Round MFN rates, the contrast to maintaining present degrees of restrictiveness for low-duty products would become particularly marked. Future GSP origin rules would appear to have largely lost their potential to complement protection of industries in preference-giving countries.

61. For such an evaluation, account should be taken of the prevailing production conditions, the cost structure and the feasibility for developing countries in general of meeting the criteria. Highly restrictive criteria can now be met by some developing countries which have become competitive in many sectors but tend to pose difficulties for the others. The various provisions for country graduation and product/country graduation introduced by major donor countries seem to aim in a different direction. At least these measures should make it possible for GSP criteria to be oriented to a greater extent by the production possibilities of the large majority of the smaller and medium-sized developing countries whose products are not the subject of graduation. Additional guidance for setting origin criteria in accordance with the prevailing production conditions in developing countries could be obtained from the origin rules applied within these countries' own subregional and regional integration groupings and preferential arrangements.

C. Cumulation

62. Cumulation met with widespread agreement and raised hopes for improvements at the Special Committee session in May 1992: "Full global cumulation was seen as having positive effects on cooperation among beneficiary countries. It would, in particular, benefit those countries outside regional groupings". 23/

63. Full, global cumulation among beneficiaries would best correspond to the global reorganization of production and investment. It would also take account of the rapidly progressing trade and investment linkages among developing countries, which have increased subsequent to the liberalization and increased outward-orientation of their government policies. Through full and global cumulation, preference-giving countries could further support and encourage the pursuit of policy reforms in preference-receiving countries.

64. The factual application of autonomous and product/country graduation in the context of many individual GSP schemes changes the previous situation and should facilitate the adoption of cumulation among beneficiary countries. Eventually, consideration may be given to enlarging the scope for global cumulation on the assumption that materials or components originating in graduated countries or in individual products graduated from the most competitive countries would not be taken into account for the purpose of GSP cumulation.

65. The policy and customs reforms undertaken by many beneficiary countries and the increasing intensity of their mutual cooperation will also be reflected in the effectiveness of, and scope for, further improving customs cooperation between preference-giving and receiving countries. This should help to remove further obstacles to applying global and full cumulation. Australia, New Zealand and Canada, which have applied global, full cumulation under their GSP schemes, could describe their experiences and make suggestions as to how remaining problems of other GSP donors could be approached.

66. Finally, it may be noted that even subregional or regional cumulation have not yet advanced as much as they could. Many subregional and regional integration groupings among developing countries, in particular in the African region, do not yet benefit even from subregional integration for GSP purposes.

Regional cumulation could also provide a boost to Africa-wide economic cooperation and integration efforts, as well as those proceeding in other developing regions.

D. Concept of donor country content

67. The concept of donor country content was another point that met with widespread agreement and raised hopes for positive improvements at the Special Committee. It was recognized that application of the donor country content would encourage foreign investment and promote international trade. Many countries had found the use of this concept consistent with the ongoing liberalization of international trade and national policies. 24/ Subsequently, a group of preference-giving countries that do not yet apply that concept expressed the opinion at the twentieth session in 1993 that "donor country content, together with regional cumulation, could increase the efficiency of the system of preferences, bearing in mind the need for special measures in favour of the least developed countries". 25/

68. Donor country content could be of particular importance for the start of new manufacturing industries in developing countries for products for consumer goods or in cases where there is a lack of financing for export production. This concept constitutes a favourable complement to the provisions for outward-processing in effect in most GSP donor countries. The customs regime provides that, on the occasion of reimports of the processed goods, only the cost of working or processing in third countries is subject to import duty but not the cost of the materials originating in the home country.

E. Special arrangements in favour of least developed countries

69. The Special Committee has achieved a broad consensus "that, in line with agreed policy, ways and means should be sought, concerning every aspect of the GSP, to offer special benefits to all the least developed countries in view of their limited industrial base and export power". 26/ Yet least developed countries continue to face substantial problems in all areas of rules of origin, from the restrictiveness of origin criteria to the administration of the scheme.

70. Special arrangements may include a system of derogation on a case-by-case basis, as applied by the EC, which, inter alia, ensures that possible disruption of the domestic market can be taken into account before a decision is taken to grant derogation. Details of the conditions that apply in the EC arrangements are given in annex IV. Another possibility is the application of a more liberal origin criterion in favour of least developed countries: for example, Canada allows up to 60 per cent imports of materials for least developed countries instead of the general 40 per cent limit. As least developed countries are unlikely to be capable of generating excessive volumes of exports, it is unclear why other preference-giving countries have not so far found it possible to adopt similar solutions.

71. Countries already applying the change in HS nomenclature should consider the feasibility of allowing least developed countries to use the change in HS headings and subheadings as a principle for determining origin (at the original 6-digit level of the Agreement on the Harmonized System). Others should stipulate lower percentage requirements, like Canada.

72. As mentioned above, donor country content would be particularly suitable for least developed countries' export capabilities, together with full cumulation with neighbouring countries of the same integration grouping within the same geographical region.

73. The need for continued technical support will be greatest in these countries and regions with regard to the application of the GSP origin rules, including in terms of advice to countries regarding the adaptation of the organization of production for exports to meet origin requirements.

F. Further simplification and improvements

74. In the event that most EFTA countries become members of the European Union, many aspects of the origin system for GSP will become substantially simplified: Austria, Finland, Sweden and Norway will take over the EC scheme of GSP. As a result, all remaining differences, as well as their notification requirements as regards certifying officials, etc., will disappear.

75. In spite of the far-reaching harmonization of many administrative and other arrangements between major GSP donor countries, some disparities continue to raise problems, as shown above. For example, direct consignment rules, where still applied, should be aligned with the direct transport rules of other GSP schemes.

76. A work programme for harmonization of process lists for GSP might further consider the feasibility of eliminating the additional requirement of minimum processes. It should, in fact, suffice to specify in a positive manner one single criterion per product. This would avoid the case in which a product meeting these criteria would be disqualified by reason of minimum processes.

77. Finally, as a counterpart and corollary to many of the suggestions made above, consideration should be given to the needs and means for intensifying mutual customs cooperation between preference-giving and preference-receiving countries and among the latter.

Notes

1/ Report of the Special Committee on Preferences on its twentieth session (TD/B/40(1)/10-TD/B/SCP/4), annex I.

2/ Report of the United Nations Conference on Trade and Development on its eighth session (TD/364), Part IV, section B, paras. 130 and 133-140.

3/ See, in particular, the Report of the Special Committee on Preferences on its nineteenth session (TD/B/39(1)/2), annex II, Chairman's Conclusions.

4/ Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations (MTN/FA, GATT), December 1993.

5/ For a detailed examination of the issue of harmonization see "Examination of definitions of 'substantial transformation' and implications of harmonization: Possible initiatives in regard to simplification and liberalization" (TD/B/C.5/141), chap. III, UNCTAD, February 1992.

6/ For the definition and discussion of such concepts as cumulation, donor country content, etc., see "Improvements in rules of origin, including harmonization: identification and promotions of possible initiatives" (TD/B/C.5/120/Corr.1), UNCTAD, 1989.

7/ See the more recent discussions on this subject reflected in the Report of the Special Committee on Preferences on its nineteenth session, (TD/B/39(1)/2), Chap. II, as well as in TD/B/C.5/120/Corr.1, annex I.

8/ Examples of this case law ruling are given in UNCTAD document UNCTAD/TAP/133/Rev.6, p. 10.

9/ See, for example, ex 4102, raw skins of sheep or lambs, without wool on: removal of wool from sheep or lambs with wool on.

10/ See, for example, headings 8469 to 8472, office equipment: manufacture in which the value of all (non-originating) materials does not exceed 40 per cent.

11/ See, for example, heading 9612, typewriter or similar ribbons: in addition to a 40 per cent maximum imported input allowance requirement, there is also a change in tariff heading requirement: all the materials used must be classified within a heading other than that of the product.

12/ See, for example, heading 8520, magnetic tape recorders and other sound recording apparatus: in addition to a 40 per cent maximum imported inputs allowance requirement, the value of all the (non-originating) materials used must not exceed the value of the originating materials and all the transistors classified under heading 8541 must be originating products.

13/ See, for example, heading 8501, electric motors and generators: within the 40 per cent maximum imported input allowance requirement, the (non-originating) materials classified within heading 8503 may only be used up to a value of 5 per cent of the ex-works price of the product.

14/ See, for example, heading 2402, cigars, cheroots, cigarillos and cigarettes of tobacco or tobacco substitutes: manufacture must include at least 70 per cent by weight of originating unmanufactured tobacco or tobacco refuse under heading 2401.

15/ See, for example, chapter 34, soap, organic surface-active agents, washing agents, etc.: materials classified within the same heading may be used provided that their value does not exceed 20 per cent of the ex-works price of the product.

16/ The materials are parts suitable for use solely or principally with the apparatus of headings 8525 to 8528.

17/ However, there are some exceptions to the new rule: "handkerchiefs" of HS heading 6213 and "shawls, etc." of heading 6214 have to be manufactured from material of fibre (chemical products, etc.), and "ties, etc." of heading 6215, "gloves, etc." of heading 6216 and "other made-up clothing accessories, etc." of heading 6217 have to be manufactured from textile yarn within a beneficiary.

18/ The certificate shall measure 210 x 297 mm. A tolerance of up to minus 5 mm or plus 8 mm in the length shall be allowed. The paper used shall be white, free of mechanical pulp, dressed for writing purposes, and weigh at least 64 g/m^2 or between 25 and 30 g/m^2 where airmail paper is used. It shall have a printed guilloche pattern background in sepia such as to reveal any falsification by mechanical or chemical means.

19/ See TD/B/40(1)/10.

20/ See Final Act Embodying the Results of the Uruguay Round Multilateral Trade Negotiations (MTN/FA/II/A1A-11).

21/ See TD/B/40(1)/10, paras. 62-64.

22/ See TD/B/39(1)/2, annex II.

23/ See TD/B/40(1)/10, annex II.

24/ See TD/B/39(1)/2, annex II.

25/ See TD/B/40(1)/10, para. 76.

26/ See TD/B/39(1)/2, annex II, para. 4.

Annex I

EXAMPLES OF OVER-STRICT ORIGIN RULES

Goods	Complaint	Complaining country
Chapter 62 Garments of woven fabric	Two-stage processing required	Bangladesh (TD/B/40(1)/10) para. 19
Chapter 62 Garments of woven fabric	Garments made from fabric not available from domestic sources do not qualify even though fabric value does not exceed 50 per cent of value of export article	Sri Lanka (TD/B/39(1)/2) para. 51
Chapter 62 Garments of woven fabric and accessories	Manufacture from yarn required for both garments and accessories (e.g. labels)	China (TD/B/1297) para. 155
Headings 85.18, 85.19, 85.20, 85.21, 85.25	Use of imported transistors disqualifies finished product	China (TD/B/1297) para. 155
Chapters 84-91 Electrical manufactures	Essential to use some imported parts. Rules restrict such parts to 5 per cent of finished product	Mexico, Singapore, Sri Lanka, Thailand (TD/B/C.5/WG(X)/2), para. 9 Malta (TD/B/39(1)/2) para. 54
Various products	United States of America rule requiring insertion of exact percentage content of each article on each certificate or origin restricts use of GSP	Mexico, Thailand (TD/B/C.5/WG(X)/2)
Various products	Percentage levels set at figures which least developed countries cannot meet	Bangladesh (TD/B/C.5/WG(X)/2)
Headings 85.25 - 85.29	Four rules of origin have to be satisfied	Malta (TD/B/39(1)/2), para. 54

Annex II

COMMON DECLARATION WITH REGARD TO PREFERENTIAL RULES OF ORIGIN

1. Recognizing that some Members apply preferential rules of origin, distinct from non-preferential rules of origin, the Members hereby agree as follows.

2. For the purposes of this Common Declaration, preferential rules of origin shall be defined as those laws, regulations and administrative determinations of general application applied by any Member to determine whether goods qualify for preferential treatment under contractual or autonomous trade regimes leading to the granting of tariff preferences going beyond the application of Article I:1 of the GATT 1994.

3. The Members agree to ensure that:

(a) when they issue administrative determinations of general application, the requirements to be fulfilled are clearly defined. In particular:

- in cases where the criterion of change of tariff classification is applied, such a preferential rule of origin, and any exceptions to the rule, must clearly specify the sub-headings or headings within the tariff nomenclature that are addressed by the rule;

- in cases where the ad valorem percentage criterion is applied, the method for calculating this percentage shall also be indicated in the preferential rules of origin;

- in cases where the criterion of manufacturing or processing operation is prescribed, the operation that confers preferential origin shall be precisely specified;

(b) their preferential rules of origin are based on a positive standard. Preferential rules of origin that state what does not confer preferential origin (negative standard) are permissible as part of a clarification of a positive standard or in individual cases where a positive determination of preferential origin is not necessary;

(c) their laws, regulations, judicial and administrative rulings of general application relating to preferential rules of origin are published as if they were subject to, and in accordance with, the provisions of Article X:1 of the GATT 1994;

(d) upon request of an exporter, importer or any person with a justifiable cause, assessments of the preferential origin they would accord to a good are issued as soon as possible but no later than 150 days* after a request for such an assessment provided that all necessary elements have been submitted. Requests for such assessments shall be accepted before trade in the good concerned begins and may be accepted at any later point in time. Such assessments shall remain valid for three years provided that the facts and conditions, including the preferential rules of origin, under which they have been made remain comparable. Provided that the parties concerned are informed in advance, such assessments will no longer be valid when a decision contrary to the assessment is made in a review as referred to in subparagraph (f) below. Such assessments shall be made publicly available subject to the provisions of subparagraph (g) below;

(e) when introducing changes to their preferential rules of origin or new preferential rules of origin, they shall not apply such changes retroactively as defined in, and without prejudice to, their laws or regulations;

(f) any administrative action which they take in relation to the determination of preferential origin is reviewable promptly by judicial, arbitral or administrative tribunals or procedures, independent of the authority issuing the determination, which can effect the modification or reversal of the determination;

(g) all information that is by nature confidential or that is provided on a confidential basis for the purpose of the application of preferential rules of origin is treated as strictly confidential by the authorities concerned, which shall not disclose it without the specific permission of the person or government providing such information, except to the extent that it may be required to be disclosed in the context of judicial proceedings.

4. The Members agree to provide to the MTO Secretariat promptly their preferential rules of origin, including a listing of the preferential arrangements to which they apply, judicial decisions, and administrative rulings of a general application relating to their preferential rules of origin in effect on the date of entry into force of this Common Declaration. Furthermore, Members agree to provide any modifications to their preferential rules of origin or new preferential rules of origin as soon as possible to the MTO Secretariat. Lists of information received and available with the MTO Secretariat shall be circulated to the Members by the MTO Secretariat.

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* In respect of requests made during the first year from entry into force of the Agreement Establishing the MTO. Members shall only be required to issue these assessments as soon as possible.

Annex III

NORTH AMERICAN FREE TRADE AGREEMENT

(a) Article 401: Originating Goods

Except as otherwise provided in this Chapter, a good shall originate in the territory of a Party provided that:

(a) the good is wholly obtained or produced in the territory of one or more of the Parties as defined in Article 415;

(b) each of the non-originating materials used in the production of the good undergoes an applicable change in tariff classification described in Annex 401.1 as a result of production occurring entirely in the territory of one or more of the Parties, and the good satisfies all other applicable requirements of this Chapter;

(c) the good is produced entirely in the territory of one or more of the Parties exclusively from originating materials; or

(d) with the exception of a good provided for in Chapters 61 through 63 of the Harmonized System, the good is produced entirely in the territory of one or more of the Parties but one or more of the non-originating parts used in the production of the good does not undergo a change in tariff classification because:

(i) the good was imported into the territory of a Party in an unassembled or a dissembled form but was classified as an assembled good pursuant to General Rule of Interpretation 2 (a) of the Harmonized System, or

(ii) the tariff heading for the good provides for both the good itself and its parts and is not further subdivided into subheadings, or the tariff subheading for the good provides for both the good itself and its parts,

provided that the good is the good specifically described by the nomenclature of the heading or subheading and that the regional value content of the good, determined in accordance with Article 402, is not less than 60 per cent where the transaction value method is used, or 50 per cent where the net cost method is used, and that the good satisfies all other applicable requirements of this Chapter.

(b) Examples of "specific rules of origin" extracted from annex 401.1

(i) Articles of apparel

6201.11- 6201.13*	A change to subheadings 6201.11 through 6201.13 from any other chapter, except from headings 51.06 through 51.13, 52.04 through 52.12, 53.07 through 53.08, 53.10 through 53.11, 55.08 through 55.16, 58.01 through 58.02, 60.01

through 60.02, or Chapter 54; provided the goods are both cut and sewn or otherwise assembled in the territory of one or more of the Parties, and visible lining fabrics listed in Note 1 satisfy the tariff change requirements provided therein.

(ii) Certain machinery

8448.11-
8448.19** A change to subheadings 8448.11 through 8448.19 from any other heading; or a change to subheadings 8448.11 through 8448.19 from any of subheadings 8448.20 through 8448.59, whether or not there is also a change from any other heading, provided there is a regional value content of not less than:

(a) 60 per cent whether the transaction value method is used; or

(b) 50 per cent where the net cost method is used.

(iii) Automobiles

Excerpt from Article 403:

"6. Notwithstanding Annex 401.1,

(a) the regional value-content requirement shall be, for a producer's fiscal year beginning nearest to 1 January 1998 and thereafter, 56 per cent under the net cost method, and for a producer's fiscal year beginning nearest to 1 January 2002 and thereafter, 62.5 per cent under the net cost method, for the following

(i) a motor vehicle provided for in subheading 8702.xx (vehicles for the transport of 15 or fewer persons), 8703.21 through 8703.90, 8704.21 or 8704.31, and

(ii) a good provided for in heading 8407 or 8408 or subheading 8708.40 which is for use as original equipment in the production of a motor vehicle identified in subparagraph (a)(i)".

Annex IV

EEC SYSTEM OF DEROGATION IN FAVOUR OF THE LEAST DEVELOPED COUNTRIES

Article 77 of Commission Regulation (EEC) No. 2454/93 of 2 July 1993 laying down provisions for the implementation of Council Regulation (EEC) No. 2913/92 establishing the Community Customs Code:

"1. Derogations to these provisions (GSP rules of origin) may be made in favour of the least developed GSP beneficiary countries when the development of existing industries or the creation of new industries justifies them. The least developed countries are those listed in the annual Council Regulations and ECSC Decisions applying generalized tariff preferences. For this purpose, the country concerned shall submit to the Commission of the European Communities a request for a derogation together with the reasons for the request in accordance with paragraph 3.

2. The examination of the requests shall in particular take into account:

(a) cases where the application of existing rules of origin would significantly affect the ability of an existing industry in the country concerned to continue its exports to the Community, with particular reference to cases where this could lead to cessation of its activities;

(b) specific cases where it can be clearly demonstrated that significant investment in an industry could be deterred by the rules of origin and where a derogation favouring the realization of the investment programme would enable these rules to be satisfied by stages;

(c) the economic and social impact of the decision to be taken especially in respect of employment.

3. In order to facilitate the examination of requests for derogation, the country making the request shall furnish the fullest possible information in support of its request, covering in particular the points listed below:

- description of the finished product;
- nature and quantity of products which have been processed there;
- manufacturing process;
- value added;
- number of employees in the undertaking concerned;
- anticipated volume of exports to the Community;
- reasons for the duration requested;
- other observations.

The same rules apply to any request for an extension.".

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REVIEW OF THE IMPLEMENTATION, MAINTENANCE, IMPROVEMENT AND UTILIZATION OF THE GENERALIZED SYSTEM OF PREFERENCES

Report of the Ad Hoc Expert Group on the Generalized System of Preferences
(24-25 February 1994)

submitted to the Secretary-General of UNCTAD

GE.94-50962 (E)

PART I: PROCEEDINGS

1. The Ad Hoc Expert Group on the Generalized System of Preferences was convened by the Secretary-General of UNCTAD in pursuance of the request made by the Special Committee on Preferences at its twentieth session to start preparations for the 1995 Policy Review on GSP and "to prepare in-depth analytical studies on the possibilities for improving the functioning and enhancing the impact of the GSP in the light of the evolution of the international economic and political environment". 1/ In preparing these studies, the Secretary-General was invited to consider "the advice of senior GSP experts, eminent personalities in international economics and international trade, academics or representatives of the business communities, from both developed and developing countries". 2/

2. The Ad Hoc Expert Group took place on 24 and 25 February 1994 in Geneva. It was chaired by Mr. Vijay Kelkar, Director, International Trade Division of UNCTAD. It had before it the following draft documentation prepared by the secretariat to be submitted to the twenty-first session of the Special Committee on Preferences: review of the implementation, maintenance, improvement and utilization of the GSP - seventeenth general report on the implementation of the generalized system of preferences: recent changes and policy issues (TD/B/SCP/6); technical assistance in connection with the GSP - Technical cooperation activities on the GSP and other trade laws, 1993 (TD/B/SCP/7); consultation on harmonization and improvement in the rules of origin - review of past discussions: recent developments; possible ways forward (TD/B/SCP/8); as well as a consultant's paper entitled "Possible improvements of the generalized system of preferences" (UNCTAD/ITD/8). The list of participating experts, who participated in their personal capacities, is contained in the annex.

PART II: CONCLUSIONS AND RECOMMENDATIONS

3. At its closing meeting, on 25 February, the Ad Hoc Expert Group agreed on the following conclusions and recommendations:

Objectives

(1) The original objectives of the GSP - trade expansion and industrialization - remain fully valid. Among them, added emphasis is being laid in the course of trade policy reforms in developing countries and countries in transition on export diversification, export capacity and competitiveness, which are necessary ingredients for the integration of the developing countries in the world trading system and their participation in the globalization of economic activity.

Principles

(2) The Group agreed that the original principles of the GSP - i.e. that it be generalized, non-discriminatory and non-reciprocal - needed to be realistically reinterpreted on a multilateral basis to give the GSP additional dynamism and impetus. The themes of harmonization and burden-sharing among the different schemes must underpin the process of revitalization of the GSP.

Benefit-sharing should not be achieved solely by decreasing the benefits of the more advanced beneficiary countries. The objective should be to increase the benefits and utilization of the GSP by the other beneficiaries.

(3) The revitalization of the GSP is specially needed in view of the reduction of preference margins as a result of the Uruguay Round, the expansion of free trade and preferential arrangements and of bilateral arrangements between preference-giving and other countries.

Duration of GSP schemes

(4) In order to increase predictability, GSP schemes should be regularly extended for a longer-term period.

Product coverage, graduation and safeguards

(5) These aspects of the GSP are closely related since comprehensive coverage is conditional on mechanisms to limit or deny preferential access when a beneficiary reaches a certain level of competitiveness or the domestic industry of the donor country is put at risk. Under such conditions, there should, however, be no major obstacles to comprehensive product coverage including all product categories, or to including them progressively in parallel with multilateral liberalization. Preference-giving countries should consult on ways to improve burden-sharing among themselves regarding coverage of particular sectors.

Country/product or sectoral graduation or differentiation

(6) A mechanism should be worked out, which should be transparent, objective, predictable and broadly agreed within a multilateral framework. Ceilings and tariff quotas are undermining the objectives of the GSP. A system of exclusion of products or product groups of competitive countries should be based on objective economic criteria, such as a combination of market-share of total donor imports, industrial capacities, level of development and export diversification. However, such country/product exclusions should be phased in over a reasonable warning period; tariff preferences should be preferably phased out progressively, where MFN duties are above a certain level; and country product exclusions should be reversible if the exclusion is no longer warranted. They should be applied on an agreed level of international tariff classification. The UNCTAD secretariat should be invited to undertake studies and simulations of the details of the mechanism.

Safeguards

(7) Most schemes incorporate a safeguard clause. These should involve an injury test along the lines of the relevant GATT provisions. The use of the safeguard clause subject to strict GATT conditions is preferable to the imposition of overall ceilings or tariff quotas.

Country graduation and beneficiary status

(8) The Group recognized that country graduation did take place but considered that country-product or product group exclusions were the preferred methods for gradually withdrawing GSP access from more advanced countries which have become competitive in these products or product groups. To the extent that country graduation did occur, it should be based on GDP per capita combined with a number of criteria, including sectoral diversification, and it should incorporate a warning period.

(9) In general, GSP status should not be limited by any conditions more restrictive than any multilateral disciplines established by the future World Trade Organization (WTO).

Annual audit

(10) Donor countries should undertake the discipline of demonstrating each year that changes in their GSP schemes, through safeguard actions, product-country exclusions, country graduation and other adjustments, increase the net value of their scheme to the beneficiaries measured as MFN tariff revenue forgone.

Special measures in favour of least developed countries

(11) The Group noted that in the case of the least developed countries the GSP needed to be supplemented by specific measures to promote trade and investment. The Group was strongly of the opinion that, in the operation of the GSP, continued differential measures in favour of the LDCs were required. Among these were extension of product coverage, exemption from the product-country exclusion procedures and, wherever possible, exemption from non-tariff trade measures on preferential exports and more liberal rules of origin.

Green GSP

(12) The Group considered possible merits and risks of recent proposals aimed at using the GSP for promoting environmentally sound production in developing countries. The Group saw several risks about the use that might be made of environmental conditions to resist the widening of coverage and general liberalization of access under the GSP, as well as the differential advantages such conditions might imply for the better-off developing countries. The Group insisted that any benefits from meeting environmental criteria must be additional to normal GSP benefits. Such a scheme should only operate in a cooperative manner and only on the basis of multilaterally agreed criteria.

A GSP for services

(13) The rapid growth of services trade and the success of the GATT negotiations raise the question of whether services exports of the developing countries could be offered preferential or differential access to the developed countries. The Group suggests that the Special Committee on Preferences should consider this issue further.

Consultation

(14) The Group was strongly of the view that changes in the rules or scope of individual GSP schemes have a great impact on beneficiaries. It invites the Special Committee to consider how it might make arrangements to reflect the beneficiary's views on such changes of GSP systems.

Rules of origin

(15) The Group noted the succession of past attempts to simplify and harmonize the rules of origin. However, in view of the problems that these rules continue to create for the utilization of the GSP and aware that coverage and country-product and country graduation were closely linked with such rules, the Group agreed that it was important to pursue those goals. It recommends that the Special Committee, in the first instance, establish a working group that includes policy-making officials from both donor and beneficiary countries to examine possible policy guidelines, taking into account such new developments as the reduction of tariffs and thus the reduced incentives to trade deflection; the new agreements in GATT on non-preferential rules of origin and the Common Declaration on preferential rules of origin; the fact that the present origin systems are quite restrictive for certain product groups; and the continued need for special measures for least developed countries.

Procedures for improving the rules of origin

(16) Regardless of the provisions in each preference-giving country's rules of origin, there will be instances in which a particular rule might be unduly restrictive. The Group discussed alternative proposals to deal with such problems. There was general agreement that such problems, including bilateral problems, might best be resolved using existing multilateral consultative procedures. Such consultations would include industry representatives from both preference-giving and preference-receiving countries, especially representatives from countries directly involved in the problem. The expected outcome of such consultations would be suggestions and recommendations for revision of the rules of origin.

Technical assistance on the GSP and other trade laws

(17) There was a consensus that the GSP technical assistance programme was an effective tool for dissemination of the GSP system and the improvement of its utilization. Bearing in mind that the GSP is one of the most remarkable achievements of UNCTAD, the Group agreed that the Programme should be continued and, to this end, recommended that:

(i) to partially offset declining resources, recipients of the Programme's assistance, i.e. preference-receiving countries, should be invited to consider various ways of contributing to it, such as trust fund contributions, or cost-sharing arrangements;

(ii) in carrying out its activities, the Programme should, inter alia, put more emphasis on rules of origin as well as on follow-up action to regional seminars, workshops and advisory missions;

(iii) the Programme should consider strengthening and deepening its activities on other trade laws issues to cover all regulations on access to markets of preference-giving countries, including investment aspects.

1/ Report of the Special Committee on Preferences on its twentieth session (TD/B/40(1)/10, annex I, para. 1.

2/ Ibid., para. 2.

Annex

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